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IN THE

Supreme Court of the United States

October Term, 1970

No. 1493

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,

Petitioners,

against

PAUL BENJAMIN,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

Supreme Court of the United States

October Term, 1970

No.

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,

Petitioners,

against

PAUL BENJAMIN,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered herein on March 5, 1971.

Opinions Below

The opinion of the Court of Appeals, as yet unreported, appears in the Appendix, *infra*, pp. 1a-6a. The opinion of the District Court is reported at 317 F. Supp. 185 and appears in the Appendix, *infra*, pp. 7a-17a.

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was entered on March 5, 1971. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Whether 28 U.S.C. § 2283 operates as a bar to the issuance of an injunction where it is necessary in aid of the District Court's jurisdiction by reason of the collateral estoppel and *res judicata* effects of a state court judgment?

2. Whether an injunction under 28 U.S.C. § 2283 may issue pursuant to 15 U.S.C. § 78u(e), § 21(e) of the Securities Exchange Act of 1934, when a litigant in a state court action is attempting to violate the provisions of Sections 10(b) and 29(b) of the Securities Exchange Act of 1934?

Statutes and Regulation

The pertinent provisions of 15 U.S.C. §§ 78j(b), 78u(e) and 78cc(b); of 28 U.S.C. §§ 1738 and 2283; and of 17 C.F.R. § 240.10b-5 are printed in the Appendix, *infra*, pp. 18a-20a.

Statement of the Case

On June 16, 1970, petitioners sued in the United States District Court for the Southern District of New York under Section 27 of the Securities Exchange Act of 1934 ("Act") (15 U.S.C. § 78aa) and asserted claims against respondent as follows: (1) a claim arising under Sections 10(b) and 29(b) of the Act (15 U.S.C. §§ 78j(b) and 78cc(b)) seeking damages and rescission for respondent's breach of a written assets acquisition agreement ("Agreement") entered into between petitioner Vernitron Corporation ("Vernitron"), respondent and two others; (2) pendent claims for breach of contract and common law fraud arising out of respondent's breaches of warranties, misrepresentations, nondisclosures and omissions in connection with the Agreement; and (3) a claim under 28 U.S.C. § 2283 to

enjoin the continued prosecution of a related state action (1-14).*

On December 20, 1967, respondent and his former company, American Medical Instrument Corporation, entered into the Agreement with petitioner Vernitron and a wholly-owned subsidiary of the New York corporate predecessor of Vernitron. The wholly-owned subsidiary, which then changed its name to American Medical Instrument Corporation, is now the other petitioner in this action.

Under the Agreement, Vernitron purchased the assets, properties, business and good will of respondent's company for Vernitron's common stock of the value of $1,500,000, a certificate representing 27,778 shares of Vernitron common stock being delivered at the closing to an escrow agent (43-92).

Under the Agreement, respondent was entitled to make demand upon Vernitron to cause to be registered certain shares of Vernitron's common stock being held in escrow. Pursuant to respondent's demand, Vernitron caused to be registered in June, 1968 approximately $250,000 of its securities, which it released from escrow and sold on respondent's behalf.

In June, 1968, after respondent was confronted by Vernitron with the fact that many more of the contracts of respondent's company were subject to the rules and regulations of the Small Business Administration than had been so warranted by respondent in the Agreement, the purchase price was reduced by $200,000 to $1,300,000 (101-102).

Subsequently, on February 1, 1969, respondent made demand upon Vernitron to register the balance of his shares which were being held in escrow. Since Vernitron

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* Unless otherwise designated, all references are to page numbers of respondent's Appendix filed with the Second Circuit Court of Appeals.

discovered that respondent had made certain other material misrepresentations, nondisclosures and omissions in connection with the negotiation and consummation of the Agreement, it refused to register the balance of the shares held in escrow.

On November 6, 1969, respondent brought his action against petitioners and another in the Supreme Court of the State of New York, County of New York, alleging four causes of action arising out of their alleged breach of the Agreement ("state action"). Petitioners counterclaimed in the state action for damages and rescission based upon breaches by respondent of eight specific warranties and representations contained in the Agreement. Petitioners claimed in the state action that the full measure of their damages was not determinable; that the earnings of respondent's company had been substantially overstated; and that as a result of the cumulative effect of all the misrepresentations, petitioners were entitled to rescind the transaction (105-114, 122-131). Since petitioners alleged that they had purchased respondent's company as an ongoing business on the basis of paying a multiple of earnings, they asserted that any misrepresentations, as set forth in their state court counterclaims, which affected such earnings, had a multiplied effect upon the damages to petitioners.

On June 2, 1970, respondent made a motion in the state action for summary judgment in the sum of $1,051,085.63, the amount allegedly owed by petitioners to respondent under the Agreement. This motion was argued on June 19, 1970, as was petitioners' cross-motion in state court to stay the continued prosecution of the state action pending the determination, in the federal action, of petitioners' federally exclusive §§ 10(b) and 29(b) claims.

Contemporaneously with the filing of the federal action on June 16, 1970 and prior to the argument of respondent's motion for summary judgment in state court, petitioners

moved in the District Court, pursuant to Rule 65 of the Federal Rules of Civil Procedure, to enjoin the state action on the ground that a judgment in that action would necessarily oust the federal court of jurisdiction to decide petitioners' federal claims and would prevent petitioners from obtaining the federal securities law relief to which they are entitled. Petitioners also sought a temporary restraining order, which was denied by the District Court.

On June 24, 1970, petitioners' motion for a preliminary injunction was argued before Judge Morris E. Lasker of the District Court who reserved decision. While that motion was *sub judice*, Justice Nathaniel Helman in the state court, by decision dated July 16, 1970, granted respondent partial summary judgment in the sum of $1,008,598.27. Justice Helman's decision necessarily decided the following factual issues: (1) that the Agreement is valid and enforceable in all respects; (2) that petitioners are not entitled to rescission of the Agreement; (3) that petitioners' claims are illusory; that petitioners' multiple of earnings/multiple of damages theory is without merit; (4) that the amount of petitioners' damages is minimal and (5) that since the proper measure of damages incurred by petitioners is the balance sheet misrepresentation figure set forth in petitioners' enumeration of determinable damages ($64,481.36), and not the indeterminable amount asserted by petitioners, the representation relating to the truth and accuracy of respondent's earnings and financial condition of his former company had in effect been "read out" of the Agreement (212-218).

By written decision of July 27, 1970, Judge Lasker of the District Court granted petitioners' motion for a preliminary injunction and stayed respondent and his attorneys from continuing the prosecution of the state court action pending the disposition of the federal proceedings (219-231). By order dated July 31, 1970, Judge Lasker required petitioners to post a bond in the sum of

$1,008,598.27, the amount determined in the state court decision, and petitioners filed a bond in this amount on August 5, 1970 (264).

Since the federal court action arises out of the same facts and transactions as the state action, but is premised upon the federally exclusive remedies provided in Sections 10(b) and 29(b) of the Act, Judge Lasker concluded that if the entry of the state court judgment were not prevented, petitioners would be collaterally estopped from proceeding in the federal action. Specifically, Judge Lasker held:

> "If [respondent] is permitted to proceed to enter judgment on the basis of the state court's opinion, the question arises as to whether [petitioners] will be collaterally estopped from establishing [their] right, under the federal law, to rescission and damages. It seems to me that in these circumstances [petitioners] will be estopped from establishing [their] multiple-of-earnings / multiple-of-damages theory, and that the consequence of such estoppel would be to deprive this court of its exclusive jurisdiction to determine claims arising under the federal securities laws and to fashion an appropriate remedy under those laws" (225).

The District Court also concluded that the Anti-Injunction Act (28 U.S.C. § 2283) did not operate as a bar to injunctive relief, since a stay of the state proceeding was "necessary in aid" of the federal court's *exclusive* jurisdiction to determine matters arising under the Act. Since the collateral estoppel and *res judicata* effects of a state court judgment would have the practical effect of ousting the District Court of its jurisdiction to determine federal claims, Judge Lasker concluded that if the state judgment were entered, petitioners' federal claims would never be litigated:

> "It follows that although the subject matter presented to the state court is for all practical purposes identical to the subject matter of the case

> before me, [petitioners have] not had and cannot have the opportunity to present to the state court [their] claims under Sections 10(b) and 29(b) of the Securities Act" (224).

On March 5, 1971, the United States Court of Appeals for the Second Circuit reversed the preliminary injunction granted in favor of petitioners and remanded the case to the District Court. In reversing the injunctive relief, the Circuit Court made it plain that the policy of 28 U.S.C. § 2283 did not require a stay of the state court proceedings since there was no real or potential conflict threatening the authority of the federal court. Specifically, the Circuit Court held "[t]he only conceivable interference here would be an attempt by the state court to determine issues of federal law, a task which it certainly has not yet undertaken and which in any event would be wholly without effect." Additionally, with respect to petitioners' argument that § 21(e) of the Act (15 U.S.C. § 78(u)) authorized the injunction in this action, the Circuit Court concluded that "[t]he plain wording of that statute would seem to foreclose [petitioners'] contention."

Reasons for Granting the Writ

This case raises significant questions involving the enforcement and interpretation of the exclusive federal securities laws rights and remedies, particularly the provisions of Sections 10(b) and 29(b) of the Act and the interplay of state and federal jurisdiction over violations thereof. Aside from the substantial questions involved in this case, petitioners believe that the decision of the Second Circuit Court of Appeals is in conflict with this Court's recent decision in *Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers,* 398 U.S. 281 (1970).

1. The Anti-Injunction Act, 28 U.S.C. § 2283, should not operate as a bar to the issuance of an injunction in the District Court by reason of the possible collateral estoppel and *res judicata* effects of a state court judgment.

Precedent is legion for the proposition that a prior state court judgment with respect to a breach of contract or common law fraud claim will preclude relitigation of the facts and issues underpinning either of those claims when asserted in the context of a Section 10(b) or Rule 10b-5(17 C.F.R. 240.10b-5) federally exclusive cause of action in the federal courts.

Dembitzer v. *The First Republic Corp. of America,* CCH Fed. Sec. L. Rep. ¶ 91,556 (S.D.N.Y. 1965), (not otherwise reported);

Kaufman v. *Shoenberg,* 154 F.Supp. 61 (D. Del. 1954);

Boothe v. *Baker Industries, Inc.,* 252 F.Supp. 168 (D. Del. 1966);

Connelly v. *Balkwill,* 174 F.Supp. 49 (N.D. Ohio 1959), *aff'd* 279 F.2d 685 (6th Cir. 1960);

Abramson v. *Pennwood Investment Corp.,* 392 F.2d 759 (2d Cir. 1968);

Wellington Computer Graphics, Inc. v. *Modell,* 315 F.Supp. 24 (S.D.N.Y. 1970);

Klein v. *Spear, Leeds & Kellogg,* 306 F.Supp. 743, 747 (S.D.N.Y. 1969).

The District Court relied on the decisions of *Connelly* v. *Balkwill, supra, Kaufman* v. *Shoenberg, supra* and *Boothe* v. *Baker Industries, Inc., supra* to support the proposition that petitioners would be collaterally estopped from establishing their right, under exclusive governing federal law, to rescission and damages, if respondent were permitted to enter his judgment in the state court action. Since petitioners' counterclaims in the state action arise out of the same factual complex as their claims in the federal court, the District Court concluded that its jurisdiction to determine

the federally exclusive claims would be ousted after a judgment were entered on the state court decision.

Boothe v. *Baker Industries, Inc., supra,* a decision relied upon by the District Court, is illustrative of the above decisions. In *Boothe* the District Court determined under the principals of *res judicata* and collateral estoppel, that a prior state court judgment operated as a bar to a subsequent Section 10(b) action in the federal court arising on the identical facts. Plaintiff in *Boothe* alleged a cause of action under Section 10(b) and Rule 10b-5 as well as Section 29(b) of the Act. Relying on the "full faith and credit clause" of the United States Constitution, Article IV, Section I, and the implementing statute, 28 U.S.C. § 1738, the District Court concluded that it was required to give the state court judgment the same force and effect it would have in the courts of the state where it was rendered.

Granting summary judgment for the defendant in the federal action, the *Boothe* court determined that two issues were actually litigated and determined in the state action: (1) the validity of a proxy statement, and (2) the fairness of a merger. In face of this prior adjudication, the District Court determined that it could not possibly find a violation of Section 10(b) or the proxy rules under the Act without "cutting the heart out of the [state court] judgment." In dismissing the federal complaint, the District Court concluded:

> "There is no reason of public policy why a final judgment such as was entered in the [state court] case should not bar further action by a stockholder attacking the same transactions whether by means of a derivative, non-derivative, or individual suit, where the prior judgment fairly interpreted, purports to do so, as does the [state court] judgment. Indeed, the desirability of ending litigation once and for all supports the view that the principle of *res judicata* or at least the narrower principle of estoppel by judgment as to matters actually litigated and decided, should be applied." *Id.* at 175.

Thus, since there exists a grave danger to petitioners that a collateral estoppel or *res judicata* effect may result from the entry of respondent's state court judgment, it is plain to see that the federal court, the exclusive forum to decide claims arising under petitioners' anti-fraud and rescission claims premised on §§ 10(b) and 29(b) of the Act, will be ousted of its jurisdiction to determine these claims.

Since petitioners believe that to permit the entry of a state court judgment where there are validly asserted federal securities law claims has the practical effect of depriving the federal court of jurisdiction to determine petitioners' claims, it is petitioners' position that the injunction should have remained in effect during the pendency of the federal proceedings in aid of the District Court's jurisdiction. The sole issue, therefore, is whether the Anti-Injunction Act, 28 U.S.C. § 2283, operates as a bar to the issuance of the injunction.

28 U.S.C. § 2283 provides:

> "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

Judge Lasker held that the "aid of its jurisdiction" exception was applicable and constituted the basis for the entry of the injunction—that since the federal courts have exclusive jurisdiction to determine violations under Sections 10(b) and 29(b) of the Act, the injunction was necessary to aid the federal court to exercise its jurisdiction, *i.e.*, that without such injunction, the federal court would be divested of its power.

In reaching his decision, Judge Lasker relied on this Court's recent decision in *Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers*, 398 U.S. 281 (1970) in which this Court held that an injunction had been

unwarranted under the facts involved, but cogently stated the rule to be:

> "[I]f the District Court does have jurisdiction, it is not enough that the requested injunction is related to that jurisdiction, but it must be *'necessary in aid of'* that jurisdiction. While this language is admittedly broad, we conclude that it implies something similar to the concept of injunctions to 'protect or effectuate' judgments. *Both exceptions to the general prohibition of § 2283 imply that some federal injunctive relief may be necessary to prevent a state court from so interfering with the federal court's consideration or disposition of the case as to seriously impair the federal court's flexibility and authority to decide that case.*" *Id.* at 295. [Emphasis supplied]

In short, petitioners contend that the entry of the state court judgment in the related action probably will cause an ouster of the federal court's jurisdiction to decide petitioners' federal claims by reason of the collateral estoppel and *res judicata* effects resulting from the state court judgment. Therefore, it is clear that the 2d Circuit's opinion flies directly in the face of this Court's decision in *Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers, supra,* since reversal of the preliminary injunction will necessarily impair the federal court's jurisdiction to decide petitioners' federally exclusive claims. Unless the Circuit Court's decision is reversed, petitioners will be deprived of their exclusive federal rights, which strong public policy dictates that they be given an opportunity to exercise.

Additionally, a federal securities law plaintiff may be irreparably damaged if the issue of damages in a state court action may be determined differently there than in the federal court because the law of remedies under Rule 10b-5 is one of the most virgin areas of the law.* Thus, since state courts are not empowered to fashion broad remedies for securities violations, which may be provided in a federal action under § 10(b) and Rule 10b-5, petitioners

would have forfeited a right to which they were entitled under a federal statute. As the court observed in the recent case of *Gottlieb* v. *Sandia American Corp.*, 304 F. Supp. 980, 981 (E.D. Pa. 1969),

> "[B]ecause most 10b-5 cases to date have been settled or otherwise resolved at the pleading stage, the law regarding remedies is still at an inchoate stage of development. [Citations]"

Therefore, since there is a strong federal policy that the issue of damages involving federal securities law claims be decided in the federal court, the injunction should have been permitted to stand.

2. Section 21(e) of the Act (15 U.S.C. § 78u(e)) constitutes an "expressly authorized by Act of Congress" exception to 28 U.S.C. § 2283 and the injunction should therefore have been permitted to stand.

Section 21(e) of the Act provides:

> "Whenever it shall appear to the Commission that any person is *engaged or about to engage in* any acts or practices which constitute or will constitute a violation of the provisions of the Act, or any rule or regulation thereunder, it may . . . bring an action . . . to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond." [Emphasis supplied.]

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* Petitioners have alleged that their damages were "indeterminate." Judge Helman rejected that argument and applied only a "Balance Sheet" test to measure damages flowing from the misrepresentations. Judge Helman's novel decision, if permitted to stand, not only rejects the multiple of earnings/multiple of damages theory, but in addition forecloses any reliance upon the profit and loss warranty made by respondent in the Agreement. Thus, the decision could become precedent for the clearly erroneous proposition that misrepresentations made as to the earnings of a business which is sold, are irrelevant to the determination of damages suffered by the buyer.

Relying on the decision of *Studebaker Corporation* v. *Gittlin*, 360 F.2d 692 (2d Cir. 1966), petitioners argued in the District Court that the injunction should issue to prevent respondent from reaping in the state court the illegal gains resulting from the fraud he perpetrated on petitioners. The Second Circuit in *Studebaker Corporation* v. *Gittlin, supra*, held that Section 21(e) of the Act permitted a private litigant to enjoin a state proceeding where a violation under the Act had occurred, on the ground that the injunction was "expressly authorized by Act of Congress" within the meaning of Section 2283.

Petitioners believe the *Studebaker* decision to be applicable here. Both in *Studebaker* and the instant matter the federal litigants were seeking to enforce the federal securities laws by preventing a violation of the Act, which would have been the result if the state court were permitted to grant the requested relief to the state court plaintiff. In the instant action, since it is charged that respondent has made false representations and nondisclosures in connection with the Agreement, and therefore his conduct was unlawful within the meaning of Section 10(b) and Rule 10b-5, the Agreement is void or voidable at the option of respondent under Section 29(b) of the Act. Hence, respondent's state court action is merely an attempt by him to circumvent the effects of Sections 10(b) and 29(b) of the Act, two federally exclusive claims, which *cannot* and *will not* be recognized by a state court * in a breach of contract claim arising out of an allegedly illegal agreement.

Thus, petitioners' efforts to stay the state court action are really an *enforcement* of the federal securities laws,

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* *American Distilling Co.* v. *Brown*, 295 N.Y. 36, 64 N.E. 2d 347 (1945); *McCollum* v. *Billings*, 53 Misc. 2d 661, 279 N.Y.S. 2d 609 (Sup. Ct. Onondaga Co. 1967); *MeKrut* v. *Gould*, 16 Misc. 2d 326, 188 N.Y.S. 2d 6 (Sup. Ct. N.Y. Co. 1959); *White* v. *Ludwig*, 32 Misc. 2d 120, 223 N.Y.S. 2d 316 (Sup. Ct. N.Y. Co. 1961), *aff'd without opinion*, 253 N.Y.S. 2d 524 (1st Dept. 1964).

since, as the state court opinion demonstrates, an allegedly illegal contract may be enforced under state law but will not be enforced under federal law due to Sections 10(b) and 29(b) of the Act.

Petitioners, therefore, believe that the Second Court improperly circumscribed the holding in *Studebaker Corporation* v. *Gittlin*, *supra*, and that the holding and rationale of that case should have caused the Circuit Court to affirm the grant of the preliminary injunction by the District Court.

CONCLUSION

For the reasons set forth above, a writ of certiorari should issue to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

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March 1971

(APPENDIX)

Opinion of Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 400 September Term, 1970

(Argued January 19, 1971. Decided March 5, 1971)

Docket No. 35375

VERNITRON CORPORATION & AMERICAN MEDICAL INSTRUMENT CORPORATION,

Plaintiff-Appellees,

against

PAUL BENJAMIN,

Defendant-Appellant.

Before:

HAYS and ANDERSON, *Circuit Judges,* and TYLER, *District Judge.**

Appeal from an order of the United States District Court for the Southern District of New York, Morris E. Lasker, District Judge, staying prosecution of an action in the Supreme Court of New York, New York County. Reversed and remanded.

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* Sitting by designation.

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CHARLES H. MILLER, New York, N. Y. (MARSHALL, BRATTER, GREENE, ALLISON & TUCKER, New York, N. Y., ARTHUR J. GINSBURG, on the brief) for appellees.

TYLER, *District Judge*

Defendant-appellant ("Benjamin") appeals from an order of the District Court for the Southern District of New York granting a preliminary injunction against his continued prosecution of an action in the Supreme Court of New York, New York County, against plaintiff-appellees ("Vernitron") and their attorneys (in their capacity as escrow agent).

In December, 1967, Benjamin executed a written contract with Vernitron for the sale of all the assets of his wholly-owned corporation, American Medical Instrument Corporation ("Amico"). The original contract provided that Benjamin was to receive $1,500,000 worth of Vernitron common stock; six months later, by mutual agreement, that figure was reduced to $1,300,000. The contract provided that the stock was to be held in escrow by Vernitron's attorneys. During the thirteen months immediately following the sale, Benjamin could demand the registration of $250,000 worth of these shares, the number of such shares to be determined by the closing price of Vernitron shares on the American Stock Exchange just prior to the expected effective date of registration. Pursuant to these terms, in June 1968, Benjamin secured the registration of and sold slightly less than $250,000 worth of stock. On February 1, 1969, Benjamin requested the registration of the balance of the shares, approximately $1,050,000 worth. To date Vernitron has failed or refused to register those remaining shares.

On November 6, 1969 Benjamin commenced an action against Vernitron in the state court alleging breach of contract. Vernitron counterclaimed, alleging breaches of eight warranties and demanding rescission for failure of consideration.

Following some discovery, on June 2, 1969, Benjamin moved for summary judgment at Special Term of the Supreme Court of New York. On June 16, three days before the adjourned return date of Benjamin's motion, Vernitron commenced this federal action wherein allegations essentially the same as its counterclaims in the state court are pleaded; in addition, the complaint pleads violations of Sections 10(b) and 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78cc(b), and common law fraud. At the same time, Vernitron brought on a motion for a preliminary injunction staying further proceedings in the state court and requesting immediate issuance of a temporary restraining order. The district court refused to issue the temporary restraining order on June 16, and three days later Benjamin's summary judgment motion was argued before Mr. Justice Helman at Special Term.

On July 16, 1970, Justice Helman filed a decision granting Benjamin partial summary judgment and denying Vernitron's motion for a stay of the state court suit. He granted partial summary judgment in the amount of $1,050,000, less the approximate sum of $42,000 which he found to be the maximum alleged value of Vernitron's counterclaims.[1] In granting partial summary judgment, Justice Helman ruled that there were insufficient factual allegations to support Vernitron's claims of "indeterminate damage" and its right to rescission.

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[1] New York CPLR § 3212(e) provides in pertinent part that ". . . in any action summary judgment may be granted as to one or more causes of action, or part thereof, in favor of any one or more parties, to the extent warranted, on such terms as may be just."

On July 27, before judgment could be entered on the basis of the opinion of Special Term, the district court filed its opinion granting Vernitron's motion for a preliminary injunction, staying Benjamin and his attorneys "during the pendency of this action from taking any steps or proceedings in the prosecution of the lawsuit" in the state court.

The district judge was of the opinion that a stay of the state court action fell within an exception to the anti-injunction statute, 28 U.S.C. §2283, as "necessary in aid" of the federal court's exclusive jurisdiction over matters arising under the Securities Exchange Act of 1934, as provided in Section 27. 15 U.S.C. § 78aa. He reasoned that any factual issues determined in the state court would have a collateral estoppel effect in the federal litigation—e.g. that Vernitron would be estopped from establishing facts determined against it in the state litigation though relevant to its rights under federal law. He concluded that the net effect of such estoppel would be to deprive the federal court of its exclusive jurisdiction over Securities Exchange Act claims.

We disagree with this ultimate conclusion. There can be no question but that the doctrine of collateral estoppel would be applied in any instance where the state court had determined a factual issue arising in a subsequent federal litigation. *Restatement of Judgments*, Chap. 3, § 68(1) (1942); *e.g. Connelly* v. *Balkwill*, 174 F. Supp. 49 (N.D. Ohio 1959). But, to justify an injunction of a state court action, "[i]t is not sufficient to show that the matter properly before a state court embraces issues within the compass of the federal suit, even if the federal court has exclusive jurisdiction over its case." *Greater Continental Corporation* v. *Schechter*, 304 F. Supp. 325, 330 (S.D.N.Y. 1969); appeal dismissed 422 F.2d 1100 (2 Cir. 1970); *accord*, *Lyons* v. *Westinghouse*, 201 F. 2d 510 (2 Cir. 1953). There

is no reason why the state court cannot or should not determine issues of fact and state law relevant thereto as they come up in the state litigation. The subsequent effect of collateral estoppel, far from requiring the federal court to stay proceedings in the state court, is a result which should be welcomed to avoid the task of reconsidering issues which have already been settled by another competent tribunal. *Klein* v. *Walston*, 432 F. 2d 936 (2 Cir. 1970); see, generally, *Restatement of Judgments*, Chap. 3, § 70 (1942).[2]

The policy of the anti-injunction statute, 28 U.S.C. § 2283, is to prohibit enjoining of state court suits except in those situations where the real or potential conflict threatens the very authority of the federal court. The only conceivable interference here would be an attempt by the state court to determine issues of federal law, a task which it certainly has not as yet undertaken and which in any event would be wholly without effect.

As to the other exceptions to Section 2283, there is no contention that an injunction is "necessary . . . to protect or effectuate" a judgment of a court of the United States." Vernitron, however, argues that an injunction is warranted by a third exception, "as expressly authorized by Act of Congress." Specifically, it relies on Section 21(e) of the Securities Exchange Act (15 U.S.C. §78u) authorizing the SEC to obtain an injunction against persons "engaged or about to engage" in acts in violation of the Securities Exchange Act. The plain wording of that statute would seem to foreclose Vernitron's contention. Moreover, *Studebaker Corporation* v. *Gittlin*, 360 F. 2d 692 (2 Cir. 1966), relied upon by Vernitron is inapposite in that the

[2] It is perhaps worth noting that the decision of this court in *Klein* v. *Walston* came down after the opinion of the district court in this case.

prosecution of the state action there relevant would itself have furthered the violation of the Securities Exchange Act.

Finally, Vernitron should not be permitted to use the exceptions to Section 2283 as a means of avoiding an adverse state decision and in effect obtaining appellate review thereof in a federal district court. See, *e.g. Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers*, 398 U.S. 281 (1970).

Reversed and remanded with the direction to forthwith vacate the stay order.

Memorandum Opinion of Lasker, *D. J.*

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

70 Civ. 2518

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,

Plaintiffs,

against

PAUL BENJAMIN,

Defendant.

Appearances:

MARSHALL, BRATTER, GREENE, ALLISON & TUCKER, 430 Park Avenue, New York, N. Y. 10022, Attorneys for Plaintiffs, of Counsel CHARLES H. MILLER, RICHARD L. BOND, ARTHUR J. GINSBURG.

PAUL, WEISS, GOLDBERG, RIFKIND, WHARTON & GARRISON, 345 Park Avenue, New York, N. Y. 10022, Attorneys for Defendant, of Counsel EDWARD N. COSTIKYAN, JOEL S. TAYLOR.

LASKER, *D.J.*

Plaintiffs move for an order restraining the defendant and his attorneys from taking any steps or proceedings in the prosecution of a lawsuit now pending in the Supreme Court of the State of New York, County of New York, between the same parties, entitled "Paul Benjamin v. Vernitron Corporation, et al." In order to avoid the confusion which would arise by referring to the parties either as

plaintiff or defendant (since Vernitron, et al., are plaintiffs here and defendants in the state court action, whereas Paul Benjamin is defendant here and, with others, plaintiff in the state court), references will be made to the parties by name.

I.

On December 20, 1967, Vernitron (a New York corporation since acquired by Vernitron, a Delaware corporation) and its affiliate entered into a written contract with Benjamin and his wholly-owned corporation, American Medical Instruments Corporation ("Amico") for sale of all the assets of Amico to the affiliate of Vernitron New York. The contract provided that Benjamin was to receive $1.5 million worth (later reduced to $1.3 million) of Vernitron common stock which was to be placed in escrow with Vernitron's attorneys, Marshall, Bratter, Greene, Allison & Tucker under prescribed conditions. The contract specified a procedure for the registration by Vernitron of the shares held in escrow for Benjamin. Pursuant to these terms, Benjamin secured the registration of slightly less than $250,000 worth of shares. In February 1969, Benjamin requested (as he had the right to) that the remainder of the shares be registered, but Vernitron refused.

On November 6, 1969, Benjamin brought suit in the Supreme Court of the State of New York, County of New York, against Vernitron, its affiliate, and Marshall, Bratter, Greene, Allison & Tucker as escrow agent. This is the action the prosecution of which Vernitron now asks this court to enjoin. In his state court suit Benjamin set forth causes of action for (1) damages of $1,050,000 for failure to register the remaining shares in escrow; (2) damages for failure to place further stock in escrow in order to total $1.3 million in value; (3) specific performance of the contract, delivery of the shares and dividends thereon; and

(4) exemplary damages. Vernitron counterclaimed, alleging breach of warranty by Benjamin and demanding rescission of the contract for failure of consideration. On June 2, 1970, Benjamin served notice of motion in the state court action for summary judgment in the amount of $1,051,085.63 on the first cause of action (together with severance thereof from the remaining causes of action).

On June 16, 1970, Vernitron commenced the instant action against Benjamin and simultaneously or at about the same time moved in the state court for a stay of further proceedings therein pending the determination of the federal court action.

In the case here, Vernitron alleges violations of Sections 10(b) and 29(b) of the Securities Exchange Act of 1934, as well as (under the pendent jurisdiction of this court) common law fraud and breach of contract. The complaint requests rescission of the contract and damages. As stated above, the instant motion asks that Benjamin and his attorneys be stayed from proceeding with the prosecution of the state case. It is Vernitron's contention that a stay of the state court proceedings is proper because a potential conflict between the state and federal jurisdictions exists, since the issues relating to its counterclaim in the state court may be decided there in such a way as to constitute *res judicata*, or so as collaterally to estop Vernitron from presenting its Securities Exchange Act claims to this court.

In reply, Benjamin argues that whatever determination may be made on his motion for summary judgment in the state court will not constitute *res judicata* or collaterally estop Vernitron from litigating its Securities Act claims here, and that in any event the anti-injunction statute, set forth in Title 28, U.S.C. § 2283, acts as a bar to this court's granting an injunction against prosecution of the state court action.

In passing, it should be noted that at the time of the argument in this court of the motion for a stay of the state court proceeding the state court had rendered no decision on Benjamin's motion for partial summary judgment, nor on Vernitron's motion for a stay. On July 16, 1970, Mr. Justice Helman filed an opinion granting Benjamin substantially the relief requested in his motion, and denying Vernitron a stay. No judgment has yet been entered pursuant to the opinion. In his decision Justice Helman found that Vernitron's damages, if any, were not, as alleged, indeterminable but, rather, ascertainable. Without a detailed explanation he ruled "as being properly placed in issue the sum of $42,487.36 as the sum in dispute", as to Benjamin's alleged breach of warranties, that the alleged breach of warranty even in the claimed amount of $65,000 could "hardly be said to constitute failure of consideration"; that there was insufficient factual data contained in Vernitron's affidavits to warrant rescission, and that the Vernitron-Benjamin contract price was not computed on the basis of a multiple of Amico's earnings. His award was in the amount of the relief requested ($1,051,085.63) less the contested claim of $42,487.36 for breach of warranty.

II.

The issues before me are (A) whether the anti-injunction statute stands as a bar to granting an injunction against prosecution of the state court proceeding; and (B) whether, even if there is no such bar, an injunction should be granted in accordance with general equitable considerations.

(A) *The Anti-Injunction Statute*

Title 28, U.S.C. § 2283, reads:

> "A court of the United States may not grant an injunction to stay proceedings in a State Court ex-

> cept as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

There is no contention that any judgment of this court exists, and consequently the third exception to the rule is inapplicable here.

Vernitron contends, under the authority of *Studebaker Corporation* v. *Gittlin*, 360 F.2d 692 (2d Cir. 1966), that there is a basis for private plaintiffs to come within the "expressly authorized" exception of 28 U.S.C. § 2283. Benjamin vigorously contests this reading of *Studebaker*, which held that under the provision of Section 21(e) of the Securities Exchange Act (15 U.S.C. § 78u) authorizing the SEC to obtain injunction against persons "engaged or about to engage" in acts in violation of the Securities Exchange Act, circumstances could exist constituting a basis for private plaintiffs to come within the "expressly authorized" exception to 28 U.S.C. § 2283.

In view of the disposition of the case set forth below, I find it unnecessary to determine whether the rule of *Studebaker* applies here except to note my skepticism that it does, in view of the substantial factual differences between the instant case and *Studebaker*.

This brings me to the determination of whether an injunction to stay the state court proceeding is authorized here as "necessary in aid" of this court's jurisdiction. I start from the significant proposition that *exclusive* jurisdiction to determine matters arising under the Securities Exchange Act of 1934 is vested in the federal courts. 15 U.S.C. § 78aa. It follows that, although the subject matter presented to the state court is for all practical purposes identical with the subject matter of the case before me, Vernitron has not had and cannot have

the opportunity to present to the state court its claims under Sections 10(b) and 29(b) of the Securities Act.

In the state court proceeding Justice Helman has already held that, under New York law, even if Vernitron can prove a case of fraud, there is no ground for rescission of the contract, and that damages for substantially the full amount requested by Benjamin are payable. He has also found that the parties did not enter into the contract on the basis upon which Vernitron claims they both relied. In this regard, Justice Helman's conclusion that there was no multiple-of-earnings basis for the contract price is especially significant, since the underpinning of Vernitron's federal claim for rescission is based on its allegation that the sales price *was* premised on an earnings multiple. Vernitron claims that its damages have been so multiplied by Benjamin's alleged misstatement of earnings that rescission is the only adequate remedy.

If Benjamin is permitted to proceed to enter judgment on the basis of the state court's opinion, the question arises as to whether Vernitron will be collaterally estopped from establishing its right, under federal law, to rescission and damages. It seems to me that in these circumstances Vernitron would be estopped from establishing its multiple-of-earnings/multiple-of-damages theory, and that the consequence of such estoppel would be to deprive this court of its exclusive jurisdiction to determine claims arising under the federal securities laws and to fashion an appropriate remedy under those laws. *Connelly* v. *Balkwill,* 174 F.Supp. 49 (N.D. Ohio 1959), aff'd 279 F.2d 685 (6th Cir. 1960); *Kaufman* v. *Shoenberg,* 154 F.Supp. 64 (D. Del. 1954) (relating to *res judicata* as distinguished from collateral estoppel); *Boothe* v. *Baker Industries, Inc.,* 262 F.Supp. 168 (D. Del. 1966).

The situation here presented is similar to the one analyzed by the Court of Appeals of this Circuit in *Greater Continental Corp.* v. *Schechter,* 422 F.2d 1100 (2d Cir.

1970). Although that opinion did not involve the anti-injunction statute, the court dealt with the analogous situation of a stay of arbitration. Holding that a stay of arbitration would be appropriate in connection with securities fraud cases, the court observed (at 1103-4):

> "The fraud issues involved in this case are within the view of Rule 10b-5, and the threat to Schechter's employment arises out of questions concerning the validity of the stock sale out of which the employment arose. Where, as here, there may be later conflicting claims of lack of jurisdiction on the part of the arbitrator, on the one hand, and of a collateral estoppel effect following the arbitrator's decision on the fraud issues, on the other, see James L. Saphier Agency, Inc. v. Green, 190 F.Supp. 713 (S.D.N.Y. 1961), aff'd 293 F.2d 769 (2d Cir. 1961); cf. Liquifuels, Inc. v. Hess Oil & Chemical Co., 281 F.Supp. 596 (S.D.N.Y. 1968), the court should consider whether the better course would not be to stay the arbitration proceeding pending prompt federal litigation of the fraud issue (i.e., disposition of Continental's claims in this suit), with expedited trial.
>
> "In this and similar cases involving fraud questions under the securities acts of 1933 and 1934, where there is a *strong federal policy in favor of determining stock fraud questions in the federal courts*, see Wilko v. Swann, *supra*, arbitration of the subsidiary employment issues which will necessarily determine the fraud questions also, may well be stayed." (Emphasis added.)

See also *Wellington Computer Graphics, Inc.* v. *Modell*, CCH Fed. Sec. L. Rep. ¶ 92,702 (S.D.N.Y. July 2, 1970), in which Judge MacMahon observed that a final judgment in the state court relating to matters also covered by the federal securities laws "would collaterally estop relitigation here of issues common to both actions."

In reaching the conclusion that the anti-injunction statute does not bar the issuance of an order restraining fur-

ther proceedings in the state case, I am not unmindful of the limitations placed by the Supreme Court in its opinion in *Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers, et al,* 38 LW 4471 (June 8, 1970), on the granting of such injunctions. However, analysis of the facts of the instant case persuades me that it is not embraced within the limitations set forth in *Atlantic.* As Mr. Justice Black wrote, the facts in *Atlantic* established that

> "In short the state and federal courts had concurrent jurisdiction in this case, and neither court was free to prevent either party from simultaneously pursuing claims in both courts. [citing cases] Therefore, the state court's assumption of jurisdiction over the state law claims and the federal preclusion issue did not hinder the federal court's jurisdiction so as to make an injunction *necessary* to aid that jurisdiction." (Emphasis in original.)

Here, however, the state court does *not* have concurrent jurisdiction with the federal court as to the Securities Exchange Act claims, and cannot and did not rule on them. But the ruling which it has handed down could well act collaterally to estop Vernitron from establishing its federal claims in this court. Accordingly, in the present circumstances, unlike *Atlantic,* an injunction appears necessary in aid of this court's jurisdiction.

(B) *General Equitable Concessions*

Having determined that the anti-injunction statute does not stand as a bar to granting the relief requested on this motion, it is necessary to apply the equitable standards by which the propriety of the issuance of an injunction is normally measured. The ordinary prerequisites to the granting of a preliminary injunction are a finding that the plaintiff will probably succeed on the merits of the case and

that without such relief it will be irreparably damaged. *Studebaker Corporation* v. *Gittlin, supra; Symington Wayne Corp.* v. *Dresser Industries, Inc.*, 383 F.2d 840 (2d Cir. 1967).

I find that the plaintiff here would be irreparably damaged if an injunction were not issued, since it would suffer the substantial risk of being collaterally estopped from presenting to this court its claims under the Securities Exchange Act.[1]

As to the probability of plaintiff's succeeding on the merits of the case, it must be conceded that Justice Helman's decision raises doubt. However, it is to be observed that Justice Helman did not, as he could not, rule on the plaintiff's causes of action under Sections 10(b) and 29(b) of the Act. Since, however, plaintiff in a federal securities case need not prove scienter, whereas he must do so under state law, the state court opinion does not compel the conclusion that Vernitron will fail to prove its case here. If the facts are as alleged by Vernitron (which is vigorously disputed by Benjamin), a violation of the Act would probably be established. That prospect appears to me to be sufficiently real to justify permitting Vernitron its day in federal court. This view is consistent with the attitude expressed by the Court of Appeals for this Circuit in *Semmes Motors, Inc., et al.* v. *Ford Motor Company* (Slip Opin. July 6, 1970, Dkt. No. 34447). There, relying on the landmark opinion of *Hamilton Watch Co.* v. *Benrus Watch Co.*, 206 F.2d 738, 740 (2d Cir. 1953), the court said:

> "In light of the imbalance of hardship, affirmance of the temporary injunction does not depend on a holding that Semmes had demonstrated a likelihood of success; it is necessary only that Semmes 'has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them a fair ground for litigation and thus for more deliberate investigation, . . .'

Memorandum Opinion of Lasker, D. J.

Refusal to restrain the state court proceeding here would prevent Vernitron from having its day in federal court on federal claims of which federal courts have exclusive jurisdiction. Granting the stay will impose on Benjamin the necessity of proving his claims on their merits under the securities laws. An additional factor of damage to Vernitron in denying the injunction would be that it would have to pay to Benjamin over $1 million, which, if it prevails on its suit here, it will of course not be required to do. Accordingly, I find that the imbalance of hardship favors Vernitron. Since it has in my opinion also raised questions on the merits sufficiently serious to call for more deliberate investigation, I find that an injunction should be granted restraining Benjamin and his attorneys from further prosecution of the state court action. However, in view of the fact that Vernitron did take seven months to institute this federal court action, and that Justice Helman has rendered a decision adverse to Vernitron in the state court, the motion to be granted here will be conditioned upon Vernitron's furnishing a sufficient bond the amount of which will be determined by the court upon submission of appropriate documentation by the parties. The parties shall submit such material forthwith.

For the reasons and upon the conditions stated above the motion is granted.

Pursuant to Rule 52(a), this opinion constitutes the findings of fact and conclusions of law of the court.

Settle order on notice.

Dated: New York, N. Y.
July 27, 1970

MORRIS E. LASKER
U.S.D.J.

FOOTNOTE

1. Benjamin contends that in taking seven months to bring this federal action Vernitron is guilty of laches such as to warrant a denial of preliminary relief. Certainly Vernitron's delay in instituting the federal suit is a relevant equitable consideration, but I am not persuaded that it is of sufficient weight to warrant a denial of a preliminary injunction if all the other factors by which the granting of preliminary relief is measured are satisfied. None of the cases cited by Benjamin as support for his proposition that delay on the part of a plaintiff constitutes grounds for refusal to grant a preliminary injunction is controlling here. All of those cases involved claims of trademark or copyright infringement in which it was found that the plaintiff's delay in seeking preliminary relief in itself proved that the damage suffered could not be serious. But claims of trademark or copyright infringement constitute a source of continuing damage, and it is quite proper to hold in such cases that a failure to seek preliminary relief may constitute an admission that the continuing damage is not serious. Here we are not dealing with a question of continuing damage. Furthermore, the failure to grant a preliminary injunction in the trademark or copyright infringement cases in no instance put the plaintiff out of court, whereas in the instant case failure to grant such preliminary relief would have precisely the result of collaterally estopping Vernitron from litigating its 10(b) and 29(b) claims.

Statutes and Regulations

15 U.S.C. § 78j:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

15 U.S.C. § 78u(e):

"Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the tices which constitute or will constitute a violation of the p provisions of this chapter, or of any rule or regulation thereunder, it may . . . bring an action . . . to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. . . ."

15 U.S.C. § 78cc(b):

"Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security

on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: . . ."

28 U.S.C. § 1738:

"The acts of the legislature of any State, Territory, or Possession of the United States, or copies thereof, shall be authenticated by affixing the seal of such State, Territory or Possession thereto.

The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken."

Statutes and Regulations

28 U.S.C. § 2283:

"A court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

17 C.F.R. § 240.10b-5:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."